T: +64 9 390 3228
M: +64 22 644 7193
E: simon@cygnuslaw.nz

Cygnus Law Ltd
Level 8
West Plaza Building
3 Albert Street
Auckland 1010

PO Box 8142
Symonds Street
Auckland 1150

cygnuslaw.nz

19 July 2017

**Financial Markets Authority**
Level 2, 1 Grey Street
Wellington 6140

**By email**: consultation@fma.govt.nz

**Cygnus Law's Submissions on FMA's consultation on proposed exemption to facilitate personalised roboadvice**

Thank you for the opportunity to provide feedback on the FMA's consultation on a proposed exemption to facilitate provision of personalised roboadvice to retail clients (**Proposal**). These submissions comprise a summary of Cygnus Law's key submissions followed by:

- Schedule 1: Detailed Submissions
- Schedule 2: Current & Proposed Regulatory Regime (under exemption)
- Schedule 3: Examples of online financial product information, guidance, sales & advice services (current & proposed)

**Cygnus Law's Preferred Option**

Cygnus Law is highly supportive of an exemption to permit personalised roboadvice in the interim and commends the FMA for taking the initiative to propose an exemption. However, Cygnus Law considers that the option presented for an exemption is not appropriate and that a better option is available. In particular, the Proposal will allow personalised roboadvice with very little regulatory oversight (including no prior checks on the providers except in relation to "good character"), which is likely to lead to non-compliant services and poor customer outcomes. In Cygnus Law's view the limitations and caps in the Proposal would not mitigate the risks presented by the proposed "light touch" approach and would tend to strongly favour services provided by product providers.

Cygnus Law submits that the exemption should require, as the key condition, that anyone seeking to rely on the exemption obtain QFE status (or update an existing status to meet roboadvice service requirements). The QFE Adviser Business Statement Guide should be updated to include minimum standards for a roboadviser service provided under the exemption. There would be no mandatory service limits or value caps. This approach has a number of benefits:

- It will give FMA and consumers greater confidence in the quality of roboadvice services provided pursuant to the exemption (so helping to meet the purposes of the Financial Advisers Act).
- It will allow service limits and value caps to be assessed on a case-by-case basis by reference to the adviser business statement.
- It is consistent with the existing financial markets regulatory framework, which requires licensing as a pre-condition to provide most financial services to retail clients.

- It is consistent with the requirement in the draft legislation that all roboadviser services obtain a financial advice firm licence, so allowing roboadvice service providers to more easily transition to the new regime, once in place.
- FMA recovers the cost of the licensing via the QFE application and variation fees.

**Regulatory Sandbox**

The Proposal has a number of the attributes of a "regulatory sandbox". Regulatory sandboxes have been implemented in other countries (including in Australia, Singapore and the UK) to support the development of new and innovative financial services businesses. However, the Proposal lacks key controls and support mechanisms that mitigate the risks arising where a regulatory sandbox is implemented.

Cygnus Law supports the development of a regulatory sandbox but only for start-up companies and only after a regulatory sandbox policy has been adopted by FMA. Cygnus Law does not consider that a regulatory sandbox approach is the best way to facilitate provision of personalised roboadvice services generally in New Zealand pending implementation of the new regime. As it is, the sandbox approach reflected in the Proposal lacks a number of key additional attributes of sandbox regimes outside New Zealand (including that in Australia). In particular, the Australian regime (as set out in ASIC's Regulation Guide 257 *Testing fintech products and services without holding an AFS or credit licence*), which the FMA appears to have referred to in developing the Proposal, has a number of additional attributes that mitigate the risks arising from the sandbox approach:

- It limits who can use the sandbox, for example existing licence holders cannot use it (this restriction does not apply in all countries that have a formal sandbox).
- ASIC assesses all applicants for the sandbox.
- It restricts the number of clients a sandbox participant can have to 100 retail clients and imposes a 12 month time limit (either of which may be extended by ASIC in exceptional circumstances).
- ASIC has a formal "Innovation Hub" that co-ordinates the sandbox process and helps to support the businesses making use of the sandbox and to apply for a licence. While the FMA does in fact provide such support this is not clearly promoted.
- ASIC has the right to revoke the right to use the sandbox.
- It has other customer protection measures, including an obligation to hold appropriate professional indemnity insurance (with cover of at least $1m).

**Investment Management**

When considering roboadvice in relation to investments discretionary investment management services (**DIMS**) are highly relevant. The term "roboadvice" originated in the USA, where (like NZ until 2014 for class DIMS and currently for FAA "personalised DIMS") DIMS is regulated as a financial "advice" service. However, investment management does not, in itself, involve "advice" (in terms of making a recommendation or giving an opinion on a financial product). So many roboadvisers in the USA and elsewhere are in fact providing what is essentially an investment management service with limited front-end advice (and in some cases this may not be personalised advice).

DIMS are permitted in New Zealand and are fully regulated. In some cases a roboadvice service may not involve DIMS (in NZ terms) because, to the extent the service involves investment management, the service is limited to managing pre-approved portfolios of Exchange Traded Funds (**ETFs**), with automatic rebalancing of the portfolios from time-to-time back to pre-approved asset class allocations. So the exemption itself does not need to address DIMS.

Yours sincerely
**Cygnus Law Ltd**

**Simon Papa**
Director

## Schedule 1- Cygnus Law's Detailed Submissions

### General Questions

| Question or paragraph number | Response |
|---|---|
| Q1. Do you support the proposed exemption from the requirement for personalised advice to retail clients to be provided by a natural person, provided this is subject to the proposed limits and conditions to provide consumer protection safeguards? Please give reasons for your view. | I support the proposed exemption but, as outlined in the introduction above, I do not support the mandatory limits and caps proposed by FMA or the proposed "light-touch" regulatory regime under the exemption. Under the Proposal no form of licence would be required to provide a roboadvice service and the standards imposed would be permissive (including lowering or removing a number of applicable Code Standards). And the roboadvice service providers would not be subject to any pre-vetting or approval other than in relation to "good character". Under the Proposal the barrier to providing roboadvice services on some category 1 and 2 products will be lower than if the advice is provided by a person (see Schedule 2). That approach is inconsistent with some purposes of the Financial Advisers Act (including those incorporated from the FMC Act), including to:<br>• Encourage public confidence in the professionalism and integrity of financial advisers and brokers.<br>• Promote the confident and informed participation of businesses, investors, and consumers in the financial markets.<br>While the Proposal supports the purpose of promoting innovation and flexibility in the financial markets, this does not in my view outweigh giving effect to the other purposes.<br><br>Licensing has become the default regulatory tool under New Zealand's financial markets law in recent years, to try to ensure that consumers are provided with compliant services. Licensing is required for most types of financial service providers servicing retail clients, including existing business types (e.g. fund managers, DIMS providers) and new business types (equity crowdfunding and P2P lending service providers). An exception is brokers/custodians- the IMF recently raised concerns about the lack of a licensing regime in that area. A licence is required to provide roboadvice in other countries, including Australia, Singapore and the UK (and as a general policy the NZ government favours harmonisation with Australian business Law). I can see no principled basis for departing from a licensing approach in the proposed roboadvice exemption. In any case, a licence will be required to provide personalised roboadvice under the new regime. The issue that arises if a licence is not required under the exemption is confirmed in the Proposal itself- "If the exemption requirements differ materially from the requirements that will apply under the new regime, having to comply with two different sets of requirements in a relatively short space of time would lead to increased regulatory burden for providers."<br><br>I think it's likely that, in the absence of licensing, non-compliant services will be delivered by roboadvisers. I don't see how restricting the scope of their services or the value of products advised on mitigates that outcome. By comparison, new service types such as crowdfunding and P2P lending services (also intermediaries), which involve relatively simple services (particularly crowdfunding), are subject to a comprehensive licensing regime. However, delivering even relatively simple financial advice on-line is likely to be a more |

| | |
|---|---|
| | complex technological exercise and the compliance obligations are higher. In the case of financial advice there is a ready-made licensing regime that already exists and can be used for roboadvice, the QFE status.<br><br>FMA has used licensing as a key requirement under other exemptions, including in relation to financial advice. For example, a key requirement for Australian financial advisers who wish to rely on the Financial Advisers (Australian Licensees) Exemption Notice 2011 is that they hold current Australian financial services licences granted by ASIC.<br><br>I've set out in Schedule 2 a landscape showing the current regime for regulating financial advice, with the addition of the Proposal outcomes for roboadvice and Cygnus Law's proposed outcomes as set out in this submission. The Proposal would result in QFEs (and others) being subject to lower standards for services they deliver using roboadvice than using human advisers. I can see no principled reason for that outcome.<br><br>The QFE licensing regime, as reflected in the Securities Commission's QFE Adviser Business Statement Guide ("**the Guide**") that is still in use, is already very flexible and could easily be updated to include roboadvice requirements. The Exemption Conditions set out in pages 9 to 12 of the Proposal could be used to update the Guide to provide for roboadvice services (to the extent not already covered in the Guide). Also, other countries have well-established licensing criteria for roboadvice services that can support updating the Guide. For example, ASIC's Regulatory Guide 255 *Providing digital financial product advice to retail clients*. Updating the Guide will not be waste of time - it can form the basis for updated minimum licence standards for roboadvice services that will be required once the new law is in force.<br><br>The Guide embeds some key requirements set out in the exemption Proposal, stating that "You should ensure that your ABS conveys your business culture, particularly how you ensure professionalism and consumer protection are embedded in governance and adviser activities". The Guide also provides for flexibility in business model, with the section covering "delivery channels for products and services" requiring the ABS to state "how advice or services are provided - whether face-to-face, by telephone, post or *internet*." (emphasis added) The Guide addresses application of the Code of Professional Conduct for AFAs, requiring that "Part 2 of your ABS must include a comparison of your business's conduct and competence requirements with those in the Code and the Act. If they are not the same, it should fully explain the differences, any compensating controls and why you believe that a similar standard of protection is achieved.". However, for the purposes of the roboadvice exemption, I consider it would be preferable to set out the Code requirements as they apply to a roboadvice service and only permit deviation from them by exception. |
| Q2. Do you agree it is appropriate for us to consider using our | I consider it is appropriate to use FMA's exemption powers to facilitate the provision of personalised roboadvice, and that the exemption power is sufficiently wide to permit FMA to grant an exemption to permit personalised roboadvice. |

<table>
<tr>
<td>exemption powers to facilitate the provision of personalised robo-advice in advance of the law reform, or do you believe that we should wait for the law reform to come into effect? Please give reasons for your answer.</td>
<td>Reasons why I consider it is appropriate are:<br>
• It's likely to be another 2 years before new legislation will permit this type of roboadvice (in circumstances where New Zealand is already several years behind other comparable countries).<br>
• Roboadvice is already able to be provided (and is provided) in relation to class advice. There are a number of non-advice (information and guidance), class advice sales services on-line. I've included examples of providers (current and upcoming) in Schedule 3. Also, FMA has applied a broad interpretation to class advice, see for example its 7 March 2017 KiwiSaver advice guidance. So permitting personalised roboadvice does not represent a fundamental change to existing law and there are potential providers who can make use of the exemption.<br>
• With respect to class advice, there's a real risk that consumers either don't understand the limitations of the advice provided (including because there are no on-line personalised advice services to compare them with) or they are forced to use limited on-line services, in the absence of alternatives (and with human advisers being more difficult and time-consuming to access). So extending roboadvice to personalised advice will benefit consumers by giving them greater choice and allowing them to better understand the limitations of existing services.<br>
• There is clear consumer interest in accessing such services on-line. An April 2017 Deloitte report in the UK on automated financial advice[1] found that at least 35% of consumers were willing to pay for automated financial advice, the highest proportion being in relation to life insurance (45%). Minter Ellison NZ in its February 2016 submissions[2] on financial advice law reform sought views of its millennial generation staff and noted that "from the Millennial Professional's perspective, personalised financial advice provided by natural persons are not only not seen as better than an automated online platform, but are seen by them as less reliable and more susceptible to human error and misunderstanding of an individual's mentality and motivation." The Deloitte study also found that there was high interest in automated advice from consumers in their early 40s. NZ has traditionally had a high and early uptake of new technologies so there's no reason to think that results in NZ would be significantly different.<br>
• Until July 2011 (when the Financial Advisers Act came into force) there were no restrictions on providing roboadvice (reflecting that there were very few legislative requirements that applied to financial advice services). Roboadvice services were first established in the United States in 2008 (after the policy work had been completed on the Financial Advisers Act).</td>
</tr>
</table>

[1] *The next frontier: The future of automated financial advice in the UK*: http://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-updated-robo-advice-new-horizons-layout-mww8.pdf.

[2] www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008/options-paper/options-paper-submissions/Minter-Ellison-Rudd-Watts.pdf.

| | |
|---|---|
| | • I don't consider there are any compelling reasons why roboadvisers cannot deliver good and compliant advice services, provided the service is well-designed and the nature of the service (and its limitations) is clearly explained to customers, and that the service ensures it excludes customers who are not appropriate for the service. While I accept that humans can address matters that computers can't, including non-verbal cues, I don't think this is a compelling reason to prevent personalised roboadvice (and there is no way currently to identify advisers who may be poor at picking up non-verbal cues). With respect to services on category 2 products, my personal experience is that the quality of service varies significantly among advisers. I want and expect better and I'm keen to see what on-line services can offer in terms of improved and more consistent service delivery.<br>• In any case, humans do not need to be removed from the service. They can play an active role, including in supporting customers to access and understand the service. It's just that those people don't need to be trained in all aspects of the advice process and don't need to hold particular qualifications or status. As I note below, advisers in relation to personal insurance already outsource parts of the advice process, including suitability analysis. So again, roboadvice is already happening and it's important that the law catches up to better regulate it and to give customers better service options.<br>• Many other countries that NZ compares itself to already permit personalised roboadvice services to operate. In all cases this has led to a wide variety of services. NZ risks falling behind other countries with respect to its own industry, with the risk that the services ultimately deployed in NZ are provided by overseas companies. |
| Q3. Do you think the costs for robo-advice providers to comply with the 'natural person' requirement (if no exemption is granted):<br>• Would be unreasonable? or<br>• Would not be justified by the benefit of compliance?<br>Please give reasons for your answer. | I think that the costs of complying with the "natural person" requirement are high. In theory that type of service could be offered now (personalised robo with human support) but no such services have arisen. That's in a context where there are otherwise numerous fintech businesses in NZ, indicating that the costs are in fact a big issue. However, human advisers already rely on a range of technology to assist them to deliver advice services. In the case of personal insurance the majority of advisers in New Zealand advising on more than one provider's products use QuoteMonster to determine suitability. Advisers rely on similar services overseas. QuoteMonster assesses and rates insurance products from a wide range of insurers and ranks them according to objective criteria. Advisers input their customer's data and QuoteMonster confirms the most suitable policies in the circumstances and provides initial quotes. |

| | |
|---|---|
| Q4. Do you support the proposed approach of granting a class exemption, or do you consider that granting individual exemptions would be more appropriate – in either case subject to limits and conditions? Please give reasons for your view. | I support a class exemption to permit roboadvice. The costs of obtaining an individual exemption are likely to be high. Even a large business may find the resource and capability required to apply for and obtain an individual exemption are too high. Given the absence of individual exemptions to date that permit roboadvice (in an environment where FinTech businesses are otherwise numerous) it's unlikely that there will be significant development in roboadvice until the law changes or a class exemption is issued.<br><br>Obtaining an individual exemption is usually expensive, including because it often requires obtaining legal advice. While the application fee for an exemption is low at $115 incl. GST, the hourly fee of $166 for staff and $230 for members is likely to lead to a significant fee, especially for what is likely to be a complex exemption in a new area. The proposed class exemption will allow much of the key policy work to be completed and embedded in the class exemption without direct cost to market participants. If Cygnus Law's proposed approach was adopted there will still be a significant cost for participants, being the cost of applying for and obtaining QFE status ($4,886.22 incl. GST) or updating QFE status (the same fees as for an exemption application noted above). However, those costs will likely be lower than for an individual exemption, the timeframe shorter and the applicant will have greater certainty about the likelihood of obtaining permission to provide roboadvice. |
| Q5. What impact would this exemption have if granted? We are particularly interested in any risks, costs, or other impacts this may have for consumers; as well as any risks, costs or other impacts this may have on providers (including robo-advice providers and other advice providers). | I've noted impacts in response to previous questions. Overall, I think the impact will be very positive, provided the approach I've proposed (based on QFE licensing) is adopted. Not only are roboadvisers capable of providing more reliable and consistent advice services, they can do so at lower cost and in more user-friendly ways, so helping to resolve the advice gap that currently exists. In terms of specific risks I note that:<br><br>• A few human advisers offering little more than just a sales process and implementation (help completing the application form) may suffer from competition from roboadvice services. Although this segment is probably small. I therefore think that risks to the market are outweighed by the opportunity. Otherwise, I don't consider that roboadvice will significantly impact existing advice businesses, particularly in the short to medium term. It's more likely early services will focus on the "advice gap", that is consumers who currently can't access or find it difficult to access affordable personalised financial advice.<br><br>• The Proposal would likely favour product providers over independent advice services. In particular, the caps on value and limits on services proposed would likely make it difficult for independent roboadvice services to establish themselves under the exemption. Product providers have more resources and benefit from existing client bases and so will have a built-in advantage. The head start this would provide may be difficult to overcome for independent services. This would drive the roboadvice market (that fills the advice gap) to one of relatively low utility limited services, focused on the product suite of one provider. While I don't think FMA should favour one channel over another, I think it's appropriate that FMA gives weight to the importance of independent advice channels, and innovative new businesses, so that consumers have the opportunity in time to use roboadvice services that search the market for the best available products in the circumstances. While requiring licensing will increase barriers to entry for new entrants to some extent, I don't think that's a sufficient argument to favour low standards |

| | |
|---|---|
| | (and the proposed limits will make it difficult for those entrants to operate in any case). The existence of an exemption itself, which sets out approved requirements to provide roboadvice, will provide certainty and in doing so significantly lower costs overall for licence applicants. Also, this is the same barrier faced by providers of equity crowdfunding and P2P lending services but numerous services have obtained licences. My proposal to also support a regulatory sandbox would help true start-ups, who need extra support early on before stepping up to obtain QFE status (or the future financial advice firm licence).<br>• FMA identifies in its Proposal "Potential harm to consumers from unsuitable roboadvice or from the failure of one of the first roboadvice offerings could, in addition to the potential financial loss suffered by individual consumers, undermine consumer confidence and have a chilling effect on the development of this sector." With respect to failure, given the nature of the service (advice only, likely one-off, and any funds paid by customers direct to product providers), the failure of a roboadvice offering appears to present relatively low risk to consumers and reputation. While consumers would not have recourse to the provider for any inappropriate advice in the event of failure, it's likely that would only become evident a long while after a business had shut down (not an uncommon occurrence under the current model). |
| Q6. What would be the impact if no exemption is granted (status quo)? We are interested in any risks, costs, or other impacts this may have for consumers; as well as any risks, costs or other impacts this may have on providers. (For providers) we are also interested in whether you would provide class robo-advice services if no exemption is granted. | There would be a number of impacts if no exemption is granted:<br>• There will be an on-going advice gap, with many consumers unable to obtain personalised advice on key products at reasonable cost, including on KiwiSaver.<br>• It will delay the efficiency gains (and fee reductions) roboadvice should provide to consumers for several years- costs of delivering financial advice services will remain high. As a rule of thumb I understand that, with respect to investment planning services/DIMS, advisers will not typically provide services for investment amounts of much below $200,000, reflecting the relatively high costs of such services. Melville Jessup Weaver in their November 2015 *Review of Retail Life Insurance Advice* report noted with respect to personal insurance that "Commission can be two times the first year's premium, volume bonuses can add 30% of premium or more and soft dollar incentives can include overseas trips to attractive locations." The report also identified concerns about insurance "churn". The value of commissions paid to personal insurance advisers (excluding those working for product providers) is approximately NZ$270m annually.<br>• For life insurance around 45% to 50% of all insurance business is transacted by financial advisers that are also actually giving personalised financial advice. The balance of cover is sold through group schemes (no individual advice), by no-advice sales people supervised in a QFE, or via direct sales. I understand that average premiums of $800 per annum are typical in direct and vertical channels, and average premiums of $2,000+ are common for advised channels. Product providers have taken larger shares of the personal insurance market over time, at the expense of advisers. While direct sales can help to bring the cost of delivering services down, consumers find it difficult to access independent advice services that advise on a wider range of potentially more appropriate products. |

| | |
|---|---|
| | • With respect to advice on personal insurance, the small scale of most personal insurance advice businesses focused on retail clients leads to high costs of service delivery, reflected in the approximate $270m commission figure noted above. No firm of RFAs specialising in retail client insurance advice has ever attained QFE status. The business model is partly driven by the requirement that advice is delivered by humans- independent advisers typically closely hold their client book rather than the business, hampering the development of more efficient corporate models. So most such advice businesses are relatively small scale with services delivered by individuals and with most marketing being very direct, relying on networks, some local advertising, with clients otherwise obtained via paid acquisition or paid referrals from product providers. The impact of this business model, together with the market power advisers hold over insurers (via dealer groups and other arrangements), and the fact that the true costs of service are not disclosed to customers in most cases, means that costs of delivery are high.<br>• The ability to deliver personalised financial advice using roboadvice provides the potential for new and more efficient business models to develop. In particular, it will support the development of larger scale businesses that can operate more efficiently and so lower costs of delivery. It also creates the real potential for larger businesses to effectively promote independent advice services (and their value) to a wide audience. Currently financial advisers as a business segment are almost invisible to consumers. So roboadvice will help to overcome the insurance "is sold not bought" sentiment, which in my view is in part a result of the inability of small firms to promote advice as a product to consumers. |
| Q7. Do you agree that there is an advice gap which means consumers are not able to access financial advice? What do you believe is the approximate balance a consumer would need for a provider or an AFA to be willing to provide advice to them? | I agree that there is an advice gap. There is numerous data from NZ and overseas identifying this as an issue. As regulatory requirements on advisers are increased under the law reform proposals that gap will only increase. It's difficult to see how that gap can be remedied in a meaningful way without personalised roboadvice as an option. |
| Q8. (For providers) Do you intend to rely on the proposed | I've spoken to a number of people who are planning to set up roboadvice services once the law changes. While not all will set up those businesses, there is clearly a high level of interest in roboadvice amongst existing advisers and others. |

| | |
|---|---|
| exemption? Why or why not? If we granted an exemption in late 2017, when would you expect to be able to launch your personalised robo-advice service? Which products would your robo-advice service provide advice on? We are interested to hear more about proposed robo-advice services, so it would be helpful to have a brief description of your proposed model. | |

**Exemption limits and conditions**

<table>
<tr>
<td>Q9. Do the proposed limits and conditions strike an appropriate balance between consumer protection and promoting innovation? Please give reasons for your view.</td>
<td>Please see my answers to question 2 above- I don't consider that a balance is struck. I think that the option presented does not allow, by design, for an appropriate balance. It appears to assume that the risk faced by consumers when using an essentially unregulated service is mitigated by the (relatively) low loss they will suffer when some unregulated services fail to provide services to an appropriate standard.<br><br>In relation to personal insurance, the breakdown below shows the impact of a $100,000 policy limit in each case compared to average quotes (in the adviser market, not direct- where the value of policies are lower so the relative proportions will be higher):<br><br>
<table>
<tr><th>Product Type</th><th>Proportion of Quotes below $100,000 Sum Insured</th></tr>
<tr><td>Life cover</td><td>6.2%</td></tr>
<tr><td>TPD</td><td>10.2%</td></tr>
<tr><td>Trauma</td><td>37.5%</td></tr>
<tr><td>Income Protection</td><td>47.1%</td></tr>
<tr><td>Mortgage Protection</td><td>91.6%</td></tr>
</table>
<br>This highlights that the limits are likely to be unworkable in practice and run a high risk of advised services that are limited to low value products that may be inappropriate for some people. This would at best favour product providers operating through direct channels.</td>
</tr>
<tr>
<td>Q10. Are any of the limits or conditions in this paper likely to cause your business unreasonable costs or make providing a personalised robo-advice service unworkable for your business? If so, please indicate which limit(s) or condition(s) do this, and what those</td>
<td>It's unlikely that a pure-play FinTech start-up could build a business case based on the proposed exemption. If we cannot draft rules which would permit that kind of innovation, we are likely to end up with consumers using overseas services, in some cases, none in others, and eventually becoming mere customers of services perfected in other markets – inevitably making legal and regulatory compromises in the face of the fait accompli- like the situation with the Taxi / Ride-sharing service Uber.</td>
</tr>
</table>

<table>
<tr><td>costs or impracticalities are. Please also propose alternative conditions that would provide a similar level of protection, if possible.</td><td></td></tr>
<tr><td>Q11. Do you agree that the exemption should be available for financial advice or an investment planning service, or do you think it should be limited to financial advice only (excluding investment planning services)? Do you agree that discretionary investment management service (DIMS) should not be covered by the exemption? Please give reasons for your view.</td><td>I think the exemption should be available for investment planning services in addition to financial advice services. This is possible under a QFE licensing model where the capability of the provider to provide investment planning services can be assessed. I don't think it should be available for DIMS.<br><br>I think there are a number of issues associated with limiting roboadvice to financial advice only:<br><br>• There is not a clear boundary between "financial advice" and "investment planning"- FMA does not provide guidance on the distinction (though there is high-level Securities Commission guidance from March 2010). To safely avoid "investment planning" roboadvice services may have to focus on the client's current financial situation only and only advise on specific products. This seems unduly restrictive and would prevent the development of services that may be of more value to consumers. The nature and scope of services can be explained to clients as part of initial disclosure. The capability of the service to deliver those services can be determined as part of the QFE assessment.<br><br>• The bigger issue for consumers is, in my view, not the absence of access to financial advice; it's that such advice is often limited advice. There are examples of on-line advice services that provide class advice. Large financial institutions already provide face-to-face class advice in many circumstances. There are also comparison sites that offer information on relative merits of financial products (primarily personal insurance). By only allowing financial advice to be provided the exemption would exacerbate a key problem with the current regime, which is that for many consumers more comprehensive financial advice is often difficult or impossible to obtain. So while financial advice-only services might serve a specific transactional need (particularly in relation to KiwiSaver) in many cases it will not respond to particular consumer needs.<br><br>• Limiting roboadvice to transactional matters also makes it more likely that consumers will not access independent advice, particularly with respect to KiwiSaver. That is because the KiwiSaver providers themselves, with their large resources and existing networks, are likely to dominate in the roboadvice space and make it more difficult for independent providers of advice to get started and to thrive. It's likely that a key strategic advantage possessed by independent providers will be the ability to take a more holistic view of their customers and to provide independent recommendations. Limiting roboadvice to financial advice will not allow them to do that.</td></tr>
</table>

| | |
|---|---|
| | • Many roboadvice services outside of New Zealand go beyond transactional decisions and assist clients to plan for future needs.<br>• This limitation makes sense with respect to a regulatory sandbox, where lower regulatory obligations are imposed on the providers.<br>• FMA states that "The roboadvice tools available today also cannot do everything that a human adviser can, such as complex financial planning services". I don't think that is a reason to remove that as an option- the market should be the arbiter of what services are provided, with licensing as the "filter".<br><br>I agree that the exemption should not extend to DIMS. The exemption power FMA proposes to use could only apply to personalised DIMS under the FAA in any case. However, it wouldn't be appropriate to exempt one category of DIMS (personalised under the FAA) and not another (personalised and class under the FMC Act). As I noted in the introduction, the term "roboadvice" originated in the USA. In the USA (like NZ until 2014 for class DIMS and currently for FAA "personalised DIMS") DIMS is regulated as a financial "advice" service. However, investment management does not, in itself, involve "advice" (in terms of making a recommendation or giving an opinion on a financial product). So many roboadvisers in the USA and elsewhere are in fact providing what is essentially an investment management service with limited front-end advice (and in some cases this may not be personalised advice). In some cases a roboadvice service may not involve DIMS (in NZ terms) because, to the extent the service involves investment management, the service is limited to managing set (and pre-approved) portfolios of ETFs, with automatic rebalancing of the portfolios from time-to-time back to approved asset class allocations. So the exemption itself does not need to address DIMS. |
| Q12. Do you agree with our proposed list of eligible products? Please indicate if there are products that should be included or excluded from this list. | FMA states that "The complexity of advice varies across the products listed above. For example, advice on managed funds would typically be relatively simple and straightforward to automate using standard algorithms. By contrast, advice on individual listed shares is much more complex and may be more difficult to automate. This may suggest that a narrower product list could be appropriate." I don't think the advice process is inherently more or less complex because of the product- it is the scope of the service and the client's needs that will determine the level of complexity. I think that FMA's statement may be mixing advice with investment management. Investment management is a core part of most investment roboadvice services but it is not "advice". I assume what FMA means is that portfolio management using ETFs is relatively simple compared to managing a portfolio of individual securities. However, I don't think that is necessarily the case. There are licensed DIMS providers who specialise in providing those types of services so it should be relatively simple, in theory, to bundle such DIMS (or simple non-DIMS) with a front end advice process to provide a roboadvice service. |

| | |
|---|---|
| | I don't agree with the proposed list of eligible products for other reasons. That list is appropriate for a regulatory sandbox with lowered barriers to entry. As was the case with limiting the scope of service, limiting the scope of product exacerbates a key problem- consumers often find it difficult to access more comprehensive financial advice services. Not only will the product restrictions reduce the potential for successful roboadvice business to develop (and so will likely allow established institutions to dominate by providing non-independent advice on their own products), it will actually make it more likely that consumers will be offered limited services.<br><br>I think that roboadvisers should be permitted to advise on personal insurance products (life, health, income protection etc). The service limitations are potentially appropriate for the regulatory sandbox but not otherwise.<br><br>Mortgages are also excluded. Again, I can see no reason in principle for that limitation– any limitations can be addressed as part of the QFE licensing/licence amendment process, where the QFE is required to set out its business model, including how it will ensure consumers are protected. |
| Q13. Should personal insurance products be included in the eligible product list? If so, should these products be capped at a certain value or have a duration limit? For example, should advice on personal insurance products be limited to products where the sum insured would not exceed $100,000 per product, or where the duration is one year or less? Please give reasons for your view. If you consider a different value cap or duration limit would be appropriate, please specify what this should be. | The proposed restricted products represent an area where fees are often the highest and most opaque. As noted in answer to question 6, NZ consumers are paying adviser fees annually of approximately $270m to access financial advice on protection products (life, health, income protection etc) (excluding payments by providers to their own personnel and nominated representatives). Fees are high for a number of reasons:<br>• Entry costs to the industry are low- there are currently no minimum qualification or other entry requirements (outside of a criminal record check when registering on the FSPR). The result is that there are a large number of advisers all chasing clients so the costs of client acquisition are a significant proportion of costs.<br>• The personal nature of financial advice (necessitated by the requirement that personalised advice be delivered by a human) means that individual advisers have close control of their client base. This drives a small business approach- there are no examples of true corporate scale organisations that advise on personal insurance for retail clients (compare that with business insurance with large brokers like Crombie Lockwood, Rothbury). The absence of scale means that costs remain high (exacerbated by lack of price transparency that makes it difficult for consumers to compare on price or to factor in the cost of advice).<br><br>The nature of personal insurance means that the proposed caps may not meet the needs of many consumers. That approach creates a risk that they will access services only offering advice at a capped level and won't understand that a higher value or longer term policy may be the better option- see also the answer to question 9. |

| | |
|---|---|
| | I think that the same analysis applies to mortgage brokers. There are examples overseas of successful roboadvisers advising on personal insurance (PolicyGenius in the US) and mortgages (Trussle in the UK). By placing restrictions on personal insurance advice the exemption will not permit the true benefit of roboadvice to be realised, which is access to good advice services at lower cost. |
| Q14. Should we also apply a value cap and/or duration limit on some or all of the other proposed eligible products? Please give reasons for your view. If you consider a value cap and/or duration limit would be appropriate, please specify what this should be. | A value cap would be appropriate for the regulatory sandbox or for certain QFE services, where the limits are validated by reference to the nature of the service, the provider's capability and the relevant market segment. What evidence is there that value caps and duration limits improve advice? What rationale can be applied to reducing standards for small products aimed at the most vulnerable of consumers? I think that advice standards should be maintained and that there should be no cap to the amounts of cover allowed. |
| Q15. Should we impose an individual client investment limit (a requirement that advice only be provided to clients seeking advice on investment amounts or investable assets of (for example) $100,000 or less per client)? Do you think there are any practical difficulties or unintended consequences that may arise from this? Please give reasons for your view. If you consider a monetary limit would be appropriate, please specify what this should be. | As above, for the regulatory sandbox but no otherwise. |
| Q16. Should we impose a limit on the total investment amount of products advised on through the robo-advice service? Or should we impose two limits, a higher limit for QFEs and a lower limit for non-QFEs? Are there any practical difficulties or | As noted, I think the better approach is to require all roboadvisers to be licensed as QFEs (with exceptions only for regulatory sandbox participants), with no pre-set limitations. Having different limits for QFEs and non-QFEs implies different standards. Given the intention of the new draft law to ensure that all adviser types operate to the same standard, having different limits is inconsistent with the policy settings that were developed to allow personalised roboadvice. |

| | |
|---|---|
| unintended consequences you can see from imposing a limit? Please give reasons for your view. If you consider a monetary limit would be appropriate, please specify what this should be. | |
| Q17. Should we prescribe the form that the status disclosure statement (that the provider is providing a personalised robo-advice service in reliance on the FMA exemption notice; and that this has not been endorsed, approved or reviewed by us) must take? Yes or no? If not, why not? | I don't consider status disclosure is appropriate, except in relation to a regulatory sandbox. As already noted, I don't see a case for allowing largely unregulated services to be deployed, with consumers expected to take risks on those services. Disclosure of that fact won't enhance confidence in the regulatory system or in FMA. While it's accepted that products come with inherent risk embedded in them, the regulatory regime in relation to financial services assumes that services should only operate if there's a high degree of confidence they will be compliant. |
| Q18. Do you think providers should have flexibility to decide how to comply with the disclosure condition, or do you think we should prescribe the form and method of disclosure - such as through a prescribed form of disclosure statement? Please give reasons for your view. For providers - what form and methods would you propose to use to comply with the disclosure condition? | No. In NZ's financial markets regulatory regime, outside of licensing, disclosure is the key mechanism for ensuring that investors are protected and can also take responsibility for their decisions, by ensuring they get information on key elements of the relevant financial product or service. Accordingly, disclosure is highly regulated. I can see no basis for allowing disclosure in the case of roboadvice to be essentially unregulated- ensuring that customers understand the nature (and limitations) of the services is critical.<br><br>I don't consider it is appropriate that the disclosure sets out risks of the services, "such as errors in the algorithm or technical difficulties resulting in algorithm failure". The service should only be permitted on the basis it will be able to deliver appropriate customer outcomes and will be compliant.<br><br>A recent RBNZ paper[3] described the different ways insurers aimed to meet their duty of disclosure of a simpler requirement – disclosing the financial stability ratings required under the Insurance (Prudential Supervision) Act 2010. That paper showed that in allowing flexibility a wide range of outcomes can occur, many of them poor. |

[3] *Thematic Review – Insurer Disclosures*, June 2017- http://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/insurers/publications/Insurance-oversight-thematic-review.pdf?la=en

| | |
|---|---|
| | Any wide discretion will likely favour product providers. My experience is that it's often difficult for smaller businesses to develop appropriate and compliant disclosure documents without significant guidance. By way of example, PDSs produced by large fund managers are often used as a key reference by smaller managers. If a discretionary regime is developed, the likely outcome is that FMA will be heavily involved regardless, with *de facto* market standards developed based on FMA feedback. This has the real potential to create inequities between providers, with some having better access to FMA and understanding of the requirements than others, with first movers being disadvantaged as the "guinea pigs" for development of disclosure. |
| Q19. Should we impose a condition that requires the provider to obtain active confirmation from the client that they have read the disclosures and agree to receiving advice through the robo-advice service on the basis described? Please give reasons for your view. | Yes, albeit with some flexibility on the method of collection to allow for innovation. |
| Q20. Do you agree with the proposed conduct obligations? Please give reasons for your view, including whether there may be any difficulties or unintended consequences from applying these to a robo-advice service. | I don't agree with FMA's narrow set of applicable code standards. I consider that the full set out of code standards should apply to all roboadvice services, except where clearly not applicable, and whether advice relates to category 1 or category 2 products. In that regard I agree with the Code Committee's 11 July 2017 submissions. |
| Q21. Are there any other conduct obligations that should apply? For example, other modified versions of the Code Standards. Please tell us why any additional obligations would be appropriate and provide proposed wording for these, if possible. | Please refer to the answer to question 20 above. |
| Q22. Do you have any feedback on the table set out in the Appendix which maps the proposed exemption | Please refer to the answer to question 20 above. |

| | |
|---|---|
| conditions to the Code Standards, Standard Conditions for AFAs and FA Act requirements for AFAs? Are there modified versions of any of these requirements that are not currently reflected in the proposed exemption conditions that should apply? Please give reasons for why any additional conditions would be appropriate and provide proposed wording for this, if possible. | |
| Q23. Should the conditions be applied in a manner that is proportionate to the size and scale of the robo-advice service offered? Please give reasons for your answer. | Please refer to the answers above generally. |
| Q24. Are there any other limits or conditions you think would be appropriate to put in place? Other | Please refer to the answers above generally. |
| Q25. As well as the exemption notice, would you find an information sheet explaining the exemption and providing guidance on how to comply with it helpful? Yes, or if not, why not? | Yes, provided that all key matters are clearly set out in the exemption notice itself. |
| Q26. Would you like to see a list of providers relying on the exemption, if granted, on our website? If not, why not? | Yes. |
| Q27. Do you think we should continue to use the term 'robo-advice', or should we use a different | "Roboadvice" is a well-established term- I can see little benefit in swimming against the tide. |

| | |
|---|---|
| term such as 'digital advice' or 'automated advice'? | |
| Q28. Do you have any other feedback or comments? | |

**Standard Condition for AFAs**

| | |
|---|---|
| 1. Requirement to have and maintain an Adviser Business Statement. | As noted above, I think this is relevant on the basis that all roboadvisers should be QFEs (except if operating out of a sandbox). |
| 2. Reporting – The AFA must report in accordance with the periodic and other reporting, accounting and notification requirements contained in the Regulatory Reporting Guide for AFAs. | Again, this is workable if all roboadvisers are QFEs. |
| 3. Notifications - The AFA must notify FMA in writing within five business days of any significant matter concerning the AFA's authorisation, or financial adviser activities, including certain specified notifications. | Agree that this be included to the extent relevant to roboadvice services. |
| 4. Records - The AFA must ensure that all records pertaining to his or her financial adviser business are available for inspection by FMA at any time. | |
| 5. Client money - Where the AFA acts as an intermediary for a client in the receipt, holding, payment or transfer of client money or client property, the AFA must act in accordance with | This is applicable but the law requires this in any case. I recommend that capability with respect receipt, holding, payment or transfer of client funds be considered under the QFE application, in the same way it is for crowdfunding and P2P lending licensees. This reflects the additional risk arising from providing the service and also handling client funds, particularly given the absence of a licensing regime currently for brokers and custodians. |

| the brokers' conduct and trust accounting obligations in Part 3A of the FA Act. | |
|---|---|
| 6. Supervising trainee advisers | Agree. |
| 7. No endorsement - The AFA must not at any time state or imply that FMA has endorsed or approved the AFA's business, advice, or solvency, or any other agreements or business arrangements of the AFA. | Not applicable. |

## Schedule 2- Current & Proposed Regulatory Regime (under exemption)

| Status | Personalised - **Category 1 Products** (roboadvice not currently permitted) | Personalised - **Category 2 Products**[1] (roboadvice not currently permitted) | **Class - all products** (roboadvice possible) | **Personalised- Investment Planning Services** (roboadvice not currently permitted) | **Personalised- Discretionary Investment Management Services (DIMS)**[2] (roboadvice possible)[3] | **Non- Discretionary Investment Management Service** (roboadvice possible)[3] | |
|---|---|---|---|---|---|---|---|
| | **Type of Financial Advice Permitted** (provided to **retail clients**) | | | | | | |
| **Licence required to provide service?** | **YES** | **NO**[4] | **NO**[4] | **YES** | **YES** | **NO** | |
| **AFA** (individual) | | | | Where specifically authorised | | | **CURRENT REGIME** |
| **RFA** (individual) | | | | | | | **CURRENT REGIME** |
| **QFE** (via individual QFE adviser – provider's products only) | | | | | | | **CURRENT REGIME** |
| **QFE** (via individual QFE adviser- products other than provider's) | | | | | | | **CURRENT REGIME** |
| **Individual/entity on the FSPR (including QFEs)** | | | | | | | **CURRENT REGIME** |
| **Individual/entity on the FSPR (including QFE)** (roboadvice only) | | Advice on loans (excl. mortgages) & some insurance permitted | | FMA seeking feedback on investment planning | | | **ROBOADVICE EXEMPTION** – **FMA PROP.** |
| **Individual/entity on the FSPR (excluding QFE)** (roboadvice only) | | | | | | | **ROBOADVICE EXEMPTION** – **CYGNUS LAW SUBMISSION** |
| **QFE** (all products) (with specific roboadvice approval) | | | | | | | **ROBOADVICE EXEMPTION** – **CYGNUS LAW SUBMISSION** |

**KEY**

- Permitted
- Not permitted
- Partially permitted/unclear

1. Category 2 products include insurance (except where investment-linked) & credit contracts (lending). The provision of credit contracts to consumers is subject to significant regulation under the CCCFA. The CCCFA permits on-line provision of services.
2. Class DIMS cannot be provided by an AFA- they must be provided under an FMC Act licence.
3. Roboadvice in this sense is limited to investment management services. The provider will need to comply with broker/custodian obligations under part 3A of the FAA- licence not required but annual assurance engagement required.
4. While the service can be provided by licensed person (AFA) or entity (QFE), it can be provided by anyone who is registered on the FSPR- registration involves very little regulatory oversight.

## Schedule 3- Examples of online financial product information, guidance, sales and advice services (current & proposed)

Sorted: https://sorted.org.nz

Invest Now: https://investnow.co.nz

Smart Shares: http://smartshares.co.nz

Savvy Kiwi: www.savvykiwi.co.nz

Volo: https://volo.nz/

Pinnacle Life: www.pinnaclelife.co.nz

Rate Booker: https://ratebroker.co.nz

Life Direct: www.lifedirect.co.nz

AA Life: www.aa.co.nz/insurance/life-insurance

Ilumony: www.grafts.nz

Teddy: www.heyteddy.co.nz